SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Kelley Analyst: Marion Mann DeJong Bill Number: SB 1920

Related Bills: See Prior Analysis Telephone: 845-6979 Amended Date: 06/20/2000

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Manufacturers' Investment Credit/Extends to Major Group of "Other" Electric Power Generation

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO _____________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED March 27, 2000, STILL APPLIES.

____ OTHER - See comments below.

SUMMARY OF BILL

Under the Bank and Corporation Tax Law (B&CTL), this bill would modify the Manufacturers' Investment Credit (MIC) to include taxpayers engaged in businesses relating to "other" electric power generation.

SUMMARY OF AMENDMENT

The June 20, 2000, amendments made the following changes:

?? Modified the definition of qualified property to include property used in businesses relating to "other" electric power generation. .

?? Modified the portion of the definition of qualified taxpayer that includes "other" electric power generating taxpayers as qualified taxpayers to specify that the taxpayer (1) not produce electricity for sale to a utility pursuant to a contract originally entered into before January 1, 2001, and (2) certify in writing to the Franchise Tax Board that the taxpayer pays its employees a living wage and provides health insurance.

The amendments resolved the department's implementation concern regarding the failure to include NAICS Code 221119 activities within the list of qualified activities under the definition of qualified property, but raised new policy, implementation and technical considerations. The amendments did not change the tax revenue estimate from the prior analyses since the prior analyses assumed that the definition of qualified property would be modified to include property used in businesses relating to "other" election power generation, and the other changes do not impact the revenue estimate.

Except for the items discussed in this analysis, the department's analyses of the bill as introduced February 24, 2000, and as amended March 27, 2000, still apply.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Johnnie Lou Rosas	7/12/00
____ N	____ OUA	__X__ PENDING		

SPECIFIC FINDINGS

Under the B&CTL, this bill would add businesses that meet the following to the definition of "qualified taxpayer" for purposes of the MIC:

?? Are engaged in businesses relating to "other" electric power generation as described in North American Industry Classification System (NAICS) Manual Code 221119, as follows:

"Establishments primarily engaged in operating electric power generation facilities (except hydroelectric, fossil fuel, and nuclear). These facilities convert other forms of energy, such as solar, wind, or tidal power, into electrical energy. The electric energy produced in these establishments is provided to electric power transmission systems or to electric power distribution systems."

?? Certify in writing to the Franchise Tax Board that they pay their employees a living wage and provide health insurance.

?? Do not produce electricity for sale to a utility pursuant to a contact originally entered into before January 1, 2001.

This bill would modify the definition of qualified property to include property used in businesses relating to "other" electric power generation (NAICS Code 221119).

This bill would modify the definition of "manufacturing" to include the production of electricity from one or more of the following energy sources: solar, wind, geothermal, solid-fuel biomass, waste tire, municipal solid waste, digester gas, or hydropower with a generating capacity of 30 megawatts or less.

This bill would modify the binding contract rules in the MIC so that purchases of equipment pursuant to a binding contract entered into before January 1, 1998, by taxpayers engaged in "other" electric power generation would not qualify for the credit. **The bill** would also change the dates in the binding contract rules for certain leases of qualified property.

This bill would require the credit to be recaptured if the qualified taxpayer engaged in "other" electronic power generation did not pay their employees a living wage and provide health insurance.

Policy Considerations

This bill would raise the following policy considerations.

?? Although this bill would require a qualified taxpayer engaged in "other" electronic power generation to provide health insurance for their employees it does not require the employer to pay for the health insurance.

?? This bill would not expand the MIC for Personal Income Tax Law (PITL) taxpayers engaged in the business activity of "other" electric power generation (NAICS Code 221119), thus creating inconsistent application of the MIC between PITL and B&CTL taxpayers. Moreover, any MIC claimed by an S corporation engaged in "other" electric power generation would not be available to the S corporation shareholders.

Implementation Considerations

This bill would raise the following implementation considerations. Department staff will work with the author and sponsor to resolve these issues as the bill moves through the Legislature.

- This bill does not make a corresponding change to the MIC under the PITL (Section 17053.49), which may cause taxpayer confusion. Taxpayers who are shareholders of an S corporation may be especially confused since a B&CTL credit cannot flow from the S corporation to the shareholder. Similarly, partnerships and their partners would be ineligible for this credit. This could lead to disputes between taxpayers and the department.

- This bill would expand the definition of manufacturing to include the production of electricity from specified energy sources. As a result, taxpayers that qualify for the MIC under existing law could claim the MIC for existing auxiliary activities that satisfy this expanded definition of manufacturing. For example, a manufacturing plant that includes on its premises a co-generation facility that produces electricity to run the manufacturing line would qualify for the MIC under the revised definition of manufacturing added by this bill. Under current law, while this co-generation facility may properly be treated as an auxiliary establishment under the SIC Manual and be assigned the same SIC Code as the manufacturing activity it supports, the costs of the property in the co-generation facility would not qualify for the MIC under the current definition of manufacturing since the property would not be treated as being used in a qualified activity. However, such activities would qualify under the manufacturing definition provided by this bill. If the author did not intend to expand the credit available to taxpayers currently qualified for the MIC, the bill should be amended so the expanded definition of manufacturing applies only to activities properly classified under NAICS Code 221119.

- The provisions relating to employee wages and health insurance are internally inconsistent. Under the definition of qualified taxpayer, "other" electric power producing taxpayers are required to certify that it pays its *employees* a living wage and provides health insurance. However, the bill then specifies that to receive a credit on or after January 1, 2001, a qualified taxpayer must provide health insurance and specified wages to *all employees employed within a targeted tax area*. Thus, it is unclear whether the wage and benefits must be provided to all employees or just employees employed within a targeted tax area. Further, the bill does not define "targeted tax area," "living wage," and "employer-sponsored health insurance." Unclear terms can cause disputes between taxpayers and the department.

- The operative dates in the bill are internally inconsistent. Because the bill is a tax levy, it would apply to taxable or income years beginning on or after January 1, 2000. However, the June 20, 2000, amendments inserted a January 1, 2001, date into the binding contract provision and the provision regarding employee wages and benefits.

?? The binding contract language for contracts relating to the production of electricity for sale to a utility was placed in the definition of "qualified taxpayer" rather than in the normal binding contract provisions of the MIC. Thus, the limitation for contracts relating to electricity for sale to a utility does not work as the author intended. According to the author's staff and the sponsor this change was made to resolve the policy consideration raised in the department's prior analysis.

Technical Considerations

Amendments 1 and 3 would correct subdivision references that changed as a result of the amendments.

Since taxpayers engaged in electric power generation do not develop or manufacture software, it is unnecessary to include their NAICS Code in the description of property used to develop or manufacture software. Amendment 2 would delete this unnecessary language.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1920
As Amended June 20, 2000

AMENDMENT 1

On page 2, line 25, strikeout "(i)" and insert "(j)".

AMENDMENT 2

On page 5, strikeout lines 37 and 38, inclusive, and insert:

Manual, 1987 edition, that is primarily used to develop or

AMENDMENT 3

On page 12, line 28, strikeout "(i)" and insert "(j)".